

FORMAL ISSUE PAPER

STATE OF CALIFORNIA
BOARD OF EQUALIZATION

Issue Paper Number 99-006



BOARD OF EQUALIZATION
KEY AGENCY ISSUE

- 3/16/99**
- ☐ Board Meeting
 - ☒ Business Taxes Committee
 - ☐ Customer Services Committee
 - ☐ Legislative Committee
 - ☐ Property Tax Committee
 - ☐ Technology & Administration Committee
 - ☐ Other
-

Regulation 1521 - Construction Contractors Taxability Of Labor Charges To Assemble And Install Modular Systems Furniture

I. ISSUE

Should Sales and Use Tax Regulation 1521, *Construction Contractors*, be amended to provide that all on-site labor to assemble, install, setup, and construct modular panelized office systems is exempt installation labor?

II. STAFF RECOMMENDATION

Staff recommends that Regulation 1521 be amended to add subdivision (c)(11) to provide that contracts to sell and install modular panelized systems are contracts for the sale of tangible personal property, that labor to assemble the systems is taxable fabrication labor, and that for ease of reporting and accounting for labor charges, a standard percentage based deduction for claiming nontaxable installation charges be added (Staff's Proposal).

III. OTHER ALTERNATIVE(S) CONSIDERED

Amend Regulation 1521 as proposed by Mr. Michael Vlaming of the Modular Installers Association to provide that contracts for the sale of modular systems furniture are construction contracts to furnish and install fixtures and all on-site labor is exempt installation labor (Alternate 1 Proposal).

IV. BACKGROUND

In August 1998, representatives from the Modular Installers Association and the Northern California Carpenters' Council (Council) requested that the Board reconsider its current interpretation of Sales and Use Tax Law section 6012 as it relates to labor contracts to assemble and install modular panelized office systems. Specifically, the representatives believe that on-site labor to construct modular systems (attaching one panel to the another) is actually installation labor rather than fabrication labor. Their premise is that although the modular "cubicle" replaces the "traditional" office (consisting of four (4) walls, a ceiling, and door), the labor involved in constructing the modular cubicle is just as specialized as the labor to construct the "traditional" office of long ago. Consequently, they believe the labor to construct modular systems is not "fabrication of property in place" as provided for in Regulation 1546, but the same type of labor used to construct the "traditional" office, which, as an improvement to realty, involves mostly exempt installation labor and minimal fabrication labor.

On September 25, 1998, staff met with representatives from the Council, the Installers Association, and one retailer to gain insight into the representatives' position. At that meeting, staff was advised that the percentage of on-site assembly (fabrication) labor had decreased over the years. According to the retailer present, the total labor percentage currently associated with his contracts for the sale and installation of modular furniture systems is approximately six percent (6%) to twelve percent (12%) of the contract price. Of that percentage, approximately six percent (6%) to fifteen percent (15%) is for the assembly of office panels and other related fabrication labor. Assuming that on-site labor is represented by 10 percent (10%) of the total contract price and 10 percent (10%) of that is for assembly, on-site fabrication labor would be only one percent (1%) of the total contract price.

At the October 14, 1998, Business Taxes Committee meeting, the request of the labor organizations was discussed. After considering the information presented by the organization representatives and staff, the Committee instructed staff to meet with other outside sources and retailers of modular systems furniture to verify the information provided and solicit additional input as to whether advances in technology had resulted in a decrease in the percentage of on-site assembly labor and a significant increase in the percentage of on-site installation labor. As instructed, staff scheduled a meeting for January 12, 1999, and sent notification of the meeting and a draft copy of proposed amendments to Regulation 1521 to approximately 140 interested parties. After discussing the issue with representatives from modular furniture manufacturers, various associations, other state agencies, and retailers, staff found that the trend towards using freestanding panel systems has increased, along with the associated assembly labor. According to the retailers and manufacturers who provided input, installation labor charges are considered to be a minimal percentage of the total contract price. However, staff did note that building standards might require attachment to realty in some areas of California, resulting in an increase in the amount of installation labor incurred.

Staff's initial proposed amendments were revised and mailed to interested parties on January 26, 1999. The Modular Installers Association then submitted proposed amendments to the regulation to provide that sales of modular systems furniture and components are subject to tax and that the related labor contracts to install, construct, and affix to realty are construction contracts. Additionally, the proposal provided a standard fifteen percent (15%) deduction of the total contract price for nontaxable charges. In order to discuss the association's proposed amendments and those provided by staff, a meeting with interested parties was held on February 16, 1999. As agreed at the meeting, staff assisted the Modular Installers Association in revising their proposed regulatory language (Alternate 1 Proposal).

DISCUSSION – APPLICATION OF SALES AND USE TAX

Revenue and Taxation Code section 6012 defines "gross receipts" to mean the total sales price, including labor or service costs and any other expense and services that are part of the sale, except for installation or application labor. Charges for labor to fabricate, manufacture, produce, process, or assemble the property sold are generally subject to tax. Labor charges for installing a completed product are not considered part of the sales price and are thus nontaxable. Nontaxable installation or application labor has been defined for sales and use tax purposes to mean labor to affix or fasten a completed object of tangible personal property in a place designated by the purchaser.

For the modular systems furniture industry, labor charges to attach panels in place, one-by-one, are generally considered charges for the fabrication/assembly of a system that does not exist until all the panels are connected. Labor charges to construct and assemble the components and accessories of the system are also considered charges for fabrication. In determining the taxability of the labor charges to attach panels in place, a misconception can occur. While the perceived nature of the property and its method of attachment may appear to govern whether the panelized system is considered an improvement to real property (realty) or merely personal property installed on the premises, such distinction is in error. On the contrary, determining the taxable status of the associated labor charges depends, in part, on whether the system itself is classified as a "fixture" when installed or tangible personal property. If the system is classified as a fixture under general California law when installed, then the contract for its sale and installation will be deemed a "construction contract" within the meaning of Regulation 1521 (a)(1)(A). In that case, the contract will not be merely for the sale and installation of tangible personal property but, instead, for the improvement of realty. Depending on when affixation to real property occurs, the contract will generally be for the sale and installation of materials, fixtures, and tangible personal property.

DISCUSSION - CONSTRUCTION CONTRACT OR SALE OF PERSONAL PROPERTY

Under Regulation 1521, “fixtures” means and includes items which are accessory to a building or other such structure and do not lose their identity as accessories when installed. Under the California Civil Code, a fixture is a thing, originally personal property, but later affixed or annexed to realty, so that it is considered real property. Section 660 of the California Civil Code establishes the fundamental rule with regard to whether or not personal property has become affixed to and a fixture of real property:

“A thing is deemed to be affixed to land when it is ...permanently resting upon it, as in the case of buildings; or permanently attached to what is thus permanent, as by means of cement, plaster, nails, bolts, or screws...”

However, the manner of annexation is not the sole factor in determining whether or not an item has become affixed to real property. Whether an “installed” modular system is deemed a fixture is dependent, in part, on whether it meets the “fundamental test” for a fixture. If the modular system meets the conditions of the fundamental test, it is deemed a fixture and the contract, in turn, considered a “construction contract.” If it does not meet the fundamental conditions, the associated contract is merely for the sale and installation of tangible personal property on the premises.

In order to classify the property, the following “three-prong” test must be considered:

1. The modular system’s manner of affixation,
2. Its adaptability to the use and purpose for which the realty is used; and
3. The intent with which the annexation is made.

In applying the “three-prong” test, one must understand that the three elements do not play equal parts. As provided by the decision in the California Supreme Court case, *Crocker National Bank v. City & County of San Francisco* (1989) 49 Cal.3d 881, 887-888:

“In resolving whether an article placed on the premises constitutes a fixture or personal property, the aforelisted three elements do not play equal parts. In making the determination in a particular case the element of intent is regarded as a crucial and overriding factor, with the other two criteria being considered only as subsidiary ingredients relevant to the determination of intent. [Citation.] [Par.] Because the legal problem here is taxability . . . and because the ‘intent’ crucial here is constructive and not actual, the test reduces itself to whether a reasonable person would consider the item to be a permanent part of the property, taking into account annexation, adaptation, and other objective manifestations of permanence. [Citation.]”

Considering that one or more modular panels are generally hard wired to an electrical system or, in some cases, bolted to the building, the system appears to meet the “affixation test.”

However, under Property Tax Rule 122.5(b)(1), property shall not be considered physically annexed to realty solely because of attachment to the realty by “quick disconnect” attachments, such as simple wiring and conduit connections. Under the same rule, when property is actually attached (by means of bolts, screws, etc.) but can be removed without material damage, it may still meet the affixation test unless there is an intent manifested by outward appearance or historic usage that the item is to be moved and used at other locations.

The second test is whether the system is adaptable to the use and structure of the building. That is, if the unattached property is a necessary, integral, or working part of the realty, it is constructively annexed. In the case of modular systems, the issue appears to depend on the permanence of the system. Generally, in distinguishing permanence from transitoriness, it is sufficient if it appears that the item is intended to remain where affixed until it is worn out, until the purpose to which the realty is devoted has been accomplished, or until the item is superseded by another article more suitable for the purpose of the realty. The importance of permanence comes into play when an item that generally would be considered machinery and equipment is so integrated into the use of the building or other such structure that it is treated as an improvement to realty. Thus, property which is used in the production, manufacturing or processing of tangible personal property, the performance of services or for other purposes (e.g. research, testing, or experimentation) not essential to the building is ordinarily treated as machinery and equipment even though it may be attached. However, such property, when essential to the building, is treated as a fixture.

As for whether the modular system meets the “adaptability test,” the very nature of the modular system appears to answer that question. In an effort to accommodate the ever changing needs of today’s business environment, a modular system is designed to be flexible and reconfigured as necessary, as well as moved to another location. In fact, flexibility in moving or reconfiguring the system is the primary basis for its current popularity. Generally, a panelized system will not wear out before it is moved and reconfigured for use in another part of the building or replaced with a newer or more decorative or functional system. Replacement of a panelized system does not generally occur because a better system has been found that is more suitable to the purpose of the realty. On the contrary, replacement generally occurs because the needs of the user have changed.

Whether the needs of the user are increased employee productivity, increased communication, lower costs per square footage, or reducing the number of offices, modular systems are generally purchased and/or reconfigured for fulfilling such needs. With such flexibility comes an understanding that the modular system is not essential to the use and structure of the building in which it is housed. The fact that earthquake standards require the bolting of certain panels or components to realty does not, in itself, result in the modular system being deemed a necessary or integral part of the realty.

However, assuming that some doubt arises upon applying the adaptability test, the third and most crucial test should settle the issue. In applying the “intent test,” the intent of the parties at time of contract may be used to determine whether the property is intended to

become a permanent addition to the realty. For example, for leased premises the lease may specifically provide that the lessee is required to remove an item at the termination of the short-term lease. In that case, there is no intent to make the lessee's property a permanent addition to realty, even when the property is affixed to the realty due to safety requirements. If, on the other hand, the terms of the lease specifically provide that the lessee is required to leave an item at the termination of the lease, it is reasonable to assume that the intent is to make the item a permanent part of the realty. However, the system would still need to be installed in such a manner that it becomes permanently affixed to the realty and, in turn, adapted for the use and purpose of the building in which it is installed to meet the total test.

In cases where the purchaser is the owner of the realty, other evidence of intent must be considered. Assuming the modular system meets the first two "fixture tests," all available facts must be considered to determine the intent of the parties to the contract. Lacking any other facts to the contrary, the general usage and purpose of modular systems evidenced by design and marketing, indicate the system is not intended to be a permanent improvement to realty. While such may not be the case in every circumstance, it is generally understood that the objective "intent" is for modular systems furniture to remain furniture, whether affixed to realty or not. In fact, industry representatives tell staff that the industry has experienced an increase in the number of "freestanding" panelized systems sold and installed, instead of an increase in the number of modular systems that are, for whatever the reason, incidentally affixed to realty.

To summarize, when the "three-prong" fixtures test is applied to contracts for the sale and installation of modular panelized systems, it is evident that such systems do not become fixtures when installed. Accordingly, the contracts are not "construction contracts" within the meaning of Regulation 1521. As evidenced by the above tests, the contracts are merely for the sale and installation of personal property. (See Comparison Table for a "side-by-side" comparison between staff's proposal and the association's proposal.)

DISCUSSION – INSTALLERS ASSOCIATION REQUEST

As stated previously, labor representatives requested that the Board reconsider its current interpretation regarding the taxability of on-site labor to construct and assemble modular systems furniture. The representatives state that they are currently working to establish a "prevailing wage" determination for the installation of modular furniture. As such, they believe the Board's position concerning on-site labor is impairing the organization's ability to obtain that determination. The representatives believe that the taxing of on-site labor can be construed as the State of California's determination that labor is not involved in the on-site assembly and installation of modular systems and, consequently, there is no need for a prevailing wage determination.

Further, the representatives advise staff that in some areas of California labor to install modular panelized office systems is generally labor that occurs after one or more panels are affixed to realty. They point out that the use of "freestanding panelized systems" is limited

due to earthquake safety requirements. Consequently, many of the panels and/or components are affixed to the realty. As they understand the Sales and Use Tax Law, such labor is considered exempt installation labor, not fabrication labor.

In discussing the issue with the representatives, staff found that a misconception exists concerning the type of labor that is commonly performed in constructing a modular system. As explained to staff, the persons installing the systems perceive all labor incurred in constructing the systems as exempt installation labor. For them, the term “installation” commonly refers to the entire process of creating an office environment for the consumer. The distinction between installation and assembly (fabrication labor) is not clearly understood, nor is it recognized as having an impact on the taxability of the associated charges. This fact has lead to the confusion that currently exists.

The representatives also believe that since the Contractors State License Board requires the installer to have a “C-61/D-34” (Limited Specialty - Prefabricated Equipment) license to perform the installation of prefabricated products, and the fact that building and electrical permits and inspections are also required, the systems should qualify for construction contract status. Accordingly, the labor incurred should be deemed installation labor. Again, a misconception exists. Determining whether the labor incurred is exempt installation or taxable fabrication is not dependent on whether contractor licenses, permits or inspections are required. On the contrary, the determining factor in distinguishing between assembly labor (taxable fabrication labor) and installation labor is the actual function and purpose of the labor performed, not the terminology of the industry or the requirements of the Contractors State License Board. Even when a contract is for the improvement of real property, taxable fabrication labor still occurs. The following hypothetical situation may help to illustrate this fact.

An electrical contractor is hired to install a very special and specific type of hanging light fixture in an office building. The components arrive at the jobsite requiring some intricate assembly prior to being installed by the contractor. Due to the highly technical nature of the lighting fixture, the electrical contractor is required to do the jobsite assembly. The contractor performs the specialized assembly, then installs each fixture, including all the electrical work.

Although the electrician in the above example performs the installation of the hanging lights (fixtures), he or she also does the specialized assembly. In essence, the electrician is performing two types of jobsite labor. One type, the jobsite assembly of the specialized hanging light is actually a step in the process of completing the fixture so it is ready to hang. If the specialized assembly had taken place at the factory, there would be no dispute that the labor incurred would have been included in the total taxable-selling price of the light fixture. However, because the remaining assembly took place at the jobsite, the electrician may believe that all of his or her jobsite labor is labor to install the fixture. Of course, as the example shows, this is not the case. In the assembly and construction of modular systems, the installing contractor is performing taxable assembly labor as well as exempt installation

labor. The fact that the labor is performed at the jobsite does not negate its taxable nature. The fact that the electrician's work is subject to permits and inspections should not be perceived as evidence that the taxable fabrication labor is actually exempt installation labor because it was performed at the jobsite by the electrician.

As for the amount and type of labor or other related services incurred in delivering, assembling, and installing a modular system, staff has encountered differing opinions between labor representatives and retailers. Although most agree that contracts to furnish and install modular systems are generally for a delivered and installed price, with total labor and service charges somewhere between 6 to 20 percent, differences exist over the percentage that represents nontaxable charges. These differences appear to be partly related to the misconception that "labor is labor" and all on-site labor is nontaxable installation labor, including charges for assembly, delivery, and the layout (staging) of the system.

Regarding the Installers Association's proposal to amend Regulation 1521 to provide that modular panelized systems are fixtures, the representatives believe the systems meet the "three-prong" fixture test discussed previously. Mr. Vlaming of the Modular Installers Association provides the following information in his February 8, 1999, proposal to amend Regulation 1521 to demonstrate that the panelized systems meet the "fixture" test.

1. "The system is usually bolted, screwed, or nailed to the building and is also hardwired to the building's electrical system;
2. The system is adapted to and used for the intended purpose of the building (office space);
3. Once constructed and affixed, the modular system usually is intended to be part of and remain with the building because of the expense of removal and its incorporation into the building structure."

When Mr. Vlaming applies the "three-prong" fixture test, a different conclusion from that of staff is reached. His conclusion results in the systems being deemed fixtures.

DISCUSSION – PREVAILING WAGE

California's prevailing wage laws represent a complicated system for ensuring that the ability to obtain a "public works" contract is not based on paying lower wage rates than a competitor. Under the law, all bidders are expected to use the same wage rates. Specifically, California law requires that not less than the general prevailing rate of per diem wages be paid to all workers employed on a public works project. Awarding bodies must obtain from the Director of the Department of Industrial Relations the current prevailing wage determinations for each craft, classification and type of worker needed to execute the public works contract. Prevailing wages is understood to mean the minimum per diem wages that can be paid to all workers employed on a public works contract for the particular craft, classification or type of work involved.

As provided in California Labor Code section 1720, “public works” means, in part, the construction, alteration, demolition, or repair work done under contract and paid for in whole or in part out of public funds. California Labor Code section 1750 provides that a “public works project” means the construction, repair, remodeling, alteration, conversion, modernization, improvement, rehabilitation, replacement, or renovation of a public building or structure. At this time, “installation” labor, other than the labor involved in the laying of carpet (under a building lease-maintenance contract or in a public building under contract and paid for in whole or in part out of public funds), does not appear to be covered under the prevailing wage. Whether fabrication labor is currently covered under the prevailing wage standards depends on whether such labor comes under the California Labor Code definition of “public works.” Without a more in-depth understanding of the “public works” issues, staff can not determine that at this time.

DISCUSSION - FEDERAL GOVERNMENT CONTRACTS

Currently, the United States Department of Defense, as articulated by the Department of the Army (Department), considers “pre-wired workstations” to be tangible personal property, whether hardwired or plugged into electrical sockets. In a March 17, 1997, policy memorandum, the Department provided guidance concerning which fund source should be used to purchase modular systems and clarified the Department of Defense’s policy regarding modular systems. That policy is as follows:

“As a matter of policy, pre-wired workstations that may be plugged into electrical sockets or that may be hardwired into the electrical system of a building, shall be considered personal property (fixed) and shall not be considered integral to the construction of a facility.”

Although sales and use tax regulatory interpretations are not governed by the policies of other regulatory agencies, consistency is beneficial when attainable. Staff’s current position is consistent with the above policy.

For sales of modular systems to the United States Government, a change in current interpretation to regard the systems as fixtures would result in a major change in tax application for the retailer, in this case, the prime contractor or person ultimately responsible for both the sale and installation of the system. Under staff’s current position, the retailer is making an exempt (retail) sale to the United States Government. Under the association’s proposal, when the contract is deemed a construction contract and the system a fixture, the retailer (contractor) would be considered the consumer of the fixture with tax due on the contractor’s cost. As provided, the contractor would owe tax on 85% of the total contract price, excluding sales of freestanding units or those items that are considered sales of tangible personal property. This will result in an additional cost factor for the contractor/retailer.

DISCUSSION - LOCAL TAX ALLOCATION ISSUES

Classifying modular systems furniture as fixtures rather than personal property will also result in allocation issues for the retailer and the jurisdictions participating in the local tax system. Under the current interpretation, i.e., that these transactions are just sales of tangible personal property, local sales tax revenue derived from such sales is reported to the jurisdiction in which the sales office of the retailer is located or through which the sale was negotiated. As provided in Regulation 1802, *Place of Sale and Use for Purposes of Bradley-Burns Uniform Local Sales and Use Taxes*, the place of sale for taxable sales of tangible personal property is the place of business of the retailer. If the retailer has more than one place of business, the sale occurs at the place of business where the principal negotiations take place.

If the transactions are regarded as installations of fixtures, as proposed, the local sales or use tax revenues will be allocated based on the location in which the fixture is installed instead of the location of the retailer. Regulation 1806, *Construction Contractors*, provides, in part, that “the jobsite is regarded as a place of business of a construction contractor or subcontractor and is the place of sale of “fixtures” furnished and installed by contractors or subcontractors.... United States contractors are consumers of both materials and fixtures, and the place of use of both is the jobsite.”

That is, retailers/contractors furnishing and installing fixtures are required to report the local sales and use tax to the location in which the fixture is installed through the medium of the countywide unallocated pools. Ultimately, this will result in a shift in tax revenues among the cities and, most likely, additional accounting procedures for the retailer/contractor.

DISCUSSION - PROPERTY TAX ISSUES

Several property tax implications arise if modular panelized office systems are treated as fixtures (real property) rather than personal property. First, unlike real property, personal property may, in whole or in part, be exempted from property taxation by the Legislature. (Article XIII, Section 1 of the California Constitution.) Personal property is and can be statutorily exempt by reason of its ownership, use, and/or type. For example, personal property owned by banks, financial corporations, and insurance companies is exempt from property tax assessment by ownership under Revenue and Taxation Code sections 23154 and 23183. While the personal property of banks and insurance companies is currently not assessable, fixtures would be subject to property tax, including special assessments.

Secondly, special assessments are levied on real property including fixtures, but not on personal property. Real property is governed by Article XIII A, is assigned a base year value and is placed on the secured roll, while personal property is appraised at market value annually and is placed on the unsecured roll. These differences in classification are important in that declines in value due to depreciation are calculated annually on personal property.

Unlike real property, personal property is not governed by the base year value limitations of Proposition 13 and can therefore be valued by giving annual consideration to its remaining economic life.

Currently, modular systems (partitions) are generally regarded as personal property under property tax rules. As provided on page 19 of the December 1998 edition of the *Assessors' Handbook Section 504* entitled Assessment of Personal Property and Fixtures:

“... Most partitions currently used in office buildings are not permanently attached or built into the structure. The partitions are designed to be rearranged easily to accommodate the current needs of the business. These types of partitions are properly classified as personal property. Partitions built into the structure or designed to function only in a specific structure are improvements. They are physically annexed and can be classified as fixtures or structures as appropriate. Partitions that are floor-to-ceiling height, and for the most part constructed at the time the building is constructed, are structure improvements. Partitions in an office space that are less-than-ceiling height, attached to the floor and constructed with studs and sheet rock or masonry materials are fixtures. In either case, the partitions may remain indefinitely.”

As defined in Paragraph 1 of Property Tax Rule 122.5(a),

“A fixture is an item of tangible property, the nature of which was originally personal, but which is classified as realty for property tax purposes because it is physically or constructively annexed to realty with the intent that it remain annexed indefinitely.”

Whether a change in classification as a fixture under Regulation 1521 would result in a like change in classification for property tax purposes is not known at this time. If a concurrent change did not occur, a great amount of confusion can be expected. If a change in classification did occur, banks and insurance companies and many office tenants would definitely experience a significant change to their current property tax treatment, most likely an increase in their taxable real property values. This, in itself, would cause some concern within that industry.

The following excerpt from a correspondence received in response to the proposed change may demonstrate some of the concerns that have already surfaced and been expressed. As stated in a February 15, 1999, facsimile,

“The proposal of Modular Installers Association (New Section 11) causing systems furniture to be defined as real property...has far reaching implications for our “for profit” customers. Including...Systems furniture being included in the real property tax base with its built in annual increases rather than the personal property roll which reduces over time...Depreciation as real property or amortization as leasehold

improvements with lives 39 years rather than 7 years presently afforded to these products as personal property. The “election to deduct” under Section 179 allowed for personal property (\$19,000 Federal, \$10,000 State) could also be lost.”

V. STAFF RECOMMENDATION

A. DESCRIPTION OF THE STAFF RECOMMENDATION

Staff recommends that Regulation 1521 be amended to add subdivision (c)(11) to provide that contracts to sell and install modular panelized systems are contracts for the sale of tangible personal property, that labor to assemble the systems is taxable fabrication labor, and that for ease of reporting and accounting for labor charges, a standard percentage based deduction for claiming nontaxable installation charges be added (Staff’s Proposal).

B. PROS OF THE STAFF RECOMMENDATION

- Consistent with other regulatory interpretations of section 6012.
- Consistent with the application of tax in other industries involved in the fabrication and assembly of tangible personal property.
- As modular furniture systems are generally not intended to be permanently in place, current interpretations properly reflect the application of tax.
- Although the contracts to sell and install modular systems are not construction contracts, inclusion in Regulation 1521 provides guidance requested by the industry.
- A standard labor deduction provides reporting ease for retailers.
- A standard labor deduction properly provides for the minimal amount of installation labor currently being reported by retailers and included in the taxable sales price.
- Consistent with property tax laws and an opinion by the Department of Defense.
- Consistent with the provisions of the California Civil Code.

C. CONS OF THE STAFF RECOMMENDATION

- Contrary to the request of the labor organization.
- May result in a reduction in tax revenue since it appears that the exempt labor portion is generally less than one percent (1%) of the total contract amount and staff is proposing a standard 2% deduction.
- Does not assist the Installers Association in their goal of obtaining a perceived equitable determination from the Director of Industrial Relations concerning “prevailing wage” standards.

D. STATUTORY OR REGULATORY CHANGE

Requires amendment to Regulation 1521, *Construction Contractors*.

E. ADMINISTRATIVE IMPACT

Other than the normal regulatory process, no impact on staff.

F. FISCAL IMPACT

1. Cost Impact

Cost would be minimal and absorbable.

2. Revenue Impact

Estimated to reduce tax revenues by approximately \$850,000 annually. See attached Revenue Estimate.

G. TAXPAYER/CUSTOMER IMPACT

Minimal impact. Regulatory amendment will provide additional clarification.

H. CRITICAL TIME FRAMES

None

VI. ALTERNATIVE 1

A. DESCRIPTION OF THE ALTERNATIVE

Amend Regulation 1521 as proposed by Mr. Michael Vlaming of the Modular Installers Association to provide that contracts for the sale of modular systems furniture are construction contracts to furnish and install fixtures and all on-site labor is exempt installation labor (Alternative 1 Proposal).

B. PROS OF THE ALTERNATIVE

- May assist the organization in meeting their long-term goals.
- Reduces the measure of tax liability within the industry.
- May simplify tax reporting for some taxpayers.

C. CONS OF THE ALTERNATIVE

- Contrary to current interpretations of section 6012.
- Makes a change that will ultimately affect the retailers of modular furniture who have not requested any change in interpretation.
- Inconsistent application of the tax with regard to other industries. Accounting for charges related to fabrication labor is generally understood.
- Result in confusion within other industries that involve the assembly and fabrication of tangible personal property.
- Does not provide an immediate solution to the organization's concern regarding "prevailing wage" requirements and standards.
- Contracts to sell, assemble, and install modular systems furniture are generally not considered construction contracts. Even if considered a construction contract, on-site fabrication labor would still occur due to the nature of the product. As such, a portion of on-site labor charges remains subject to tax. Proposal does not provide for this.
- Inconsistent with current property tax interpretations.
- Inconsistent with the Federal Government's treatment of modular systems.
- Results in local tax allocation issues.
- Increased costs for retailer when customer is the Federal Government.
- Increased accounting and record keeping, and additional complexity for the taxpayer.

D. STATUTORY OR REGULATORY CHANGE

Requires amendment to Regulation 1521. May require statutory change.

E. ADMINISTRATIVE IMPACT

Staff will require notification of the change in interpretation, as will taxpayers.

F. FISCAL IMPACT

1. Cost Impact

Cost would be minimal and absorbable.

2. Revenue Impact

Estimated to reduce tax revenues by approximately \$5.6 million annually. See attached Revenue Estimate.

G. TAXPAYER/CUSTOMER IMPACT

As the retailer is not the entity requesting the change in interpretation, expected to have a significant impact on the industry. Will require clarification concerning the aspects of fabrication labor in general, as well as a detailed explanation of how tax will apply in the future.

H. CRITICAL TIME FRAMES

None

Prepared by: Program Planning Division, Sales and Use Tax Department.

Current as of: March 5, 1999.

BOARD OF EQUALIZATION
REVENUE ESTIMATE

**REGULATION 1521 – CONSTRUCTION CONTRACTORS
MODULAR SYSTEMS FURNITURE
ISSUE PAPER NUMBER 99-006**

Proposal

The staff recommendation and the alternative proposal call for a specified percentage of the contract price for the sale and installation of modular systems furniture to be presumed to be a charge for installation labor and, therefore, not subject to sales tax. The staff recommendation is 2 percent; the alternative is 15 percent.

Background, Methodology, and Assumptions

Based on data supplied by the office furniture manufacturing industry we estimate that contracts for the sale and installation of modular systems furniture in the U. S. amount to between \$4 billion and \$5 billion annually. Assuming that California represents about 12% of the national total places California sales between \$480 million and \$600 million, say \$540 million.

An average sales tax rate of 7.92 percent applied against the \$540 million would yield \$42.8 million in sales tax.

Contract prices generally include, in addition to the charges for the system components, charges to assemble and install the system. Assembly, or fabrication, labor (e.g. attaching components to each other) is subject to sales tax; installation labor (e.g. bolting components to the floor) is not subject to sales tax. Based on conversations with a number of contractors, most currently pay sales tax based upon the entire contract price, rather than trying to segregate the relatively small portion of the contract attributable to installation labor.

The staff recommendation of a 2 percent allowance would reduce tax revenue by \$42.8 million x .02 = \$856,000 compared to the revenue resulting from taxing the entire contract price. Since some contractors do already take a deduction for installation labor, the reduction in actual collections would be something less than the \$856,000. Adopting the alternative allowance would reduce tax revenue by \$42.8 million x .15 = \$6,420,000 compared to the revenue resulting from taxing the entire contract price. That's a reduction of \$5,564,000 more than the staff recommendation.

Revenue Summary

The staff recommendation would have an annual revenue effect of reducing sales tax revenue by an estimated maximum of \$850,000, depending upon the deductions for installation labor that are already being claimed by contractors. The alternative would reduce sales tax revenues by about \$5.6 million annually in addition to the reduction resulting from the staff recommendation.

Qualifying Remarks

Treating modular systems as fixtures rather than personal property could result in some currently exempt sales to the U.S. government becoming taxable.

Preparation

This revenue estimate was prepared by Jeff Reynolds, Statistics Section, Agency Planning and Research Division. It was reviewed by Ms. Laurie Frost, Chief, Agency Planning and Research Division. For additional information, please contact Mr. Reynolds at (916) 445-0840.

Current as of March 4, 1999

Regulation 1521 – Construction Contractors *Comparison Between Staff’s Version and the Installer’s Proposed Language*

STAFF’S PROPOSED AMENDMENT	INSTALLER’S PROPOSED CHANGES	COMMENTS
<p>New Section Proposed by Staff:</p> <p><u>(11) Modular Systems Furniture. Modular systems furniture is tangible personal property, whether or not affixed to realty. A contract to sell and install modular systems furniture is a contract for the sale of tangible personal property and is not a construction contract. Persons who contract to sell and install modular systems furniture are retailers of the items which they sell and install, and tax applies to the entire contract price less those charges excludable from gross receipts or sales price pursuant to Sections 6011 and 6012 of the Revenue and Taxation Code. Retailers who claim a deduction for such charges should maintain complete and detailed records to support the amounts claimed. Such records should include, but not be limited to, a separate accounting of charges for installation labor, such as labor to affix, bolt, fasten, or hardwire panels to realty and labor to fasten or affix fully constructed components to fully constructed panel systems or other components. Charges for fabrication labor, such as labor to attach, assemble, connect, construct, or fabricate panel systems or components,</u></p>	<p>New Section Proposed by the Installers:</p> <p><u>(11) Modular Systems Furniture. Except as provided below, a contract to sell and install modular systems furniture, including panelized office systems, freestanding units or other systems, is not a construction contract. Persons who contract to sell and install modular systems furniture are retailers of the items which they sell and install, and tax applies to the entire contract price less those charges excludable from gross receipts or sales price pursuant to Sections 6011 and 6012 of the Revenue and Taxation Code. Retailers who claim a deduction for such charges should maintain complete and detailed records to support the amounts claimed. Such records should include, but not be limited to, a separate accounting of charges for installation labor, such as labor to affix, bolt, fasten, or hardwire panels to realty and labor to fasten or affix fully constructed components to fully constructed panel systems or other components. Charges for fabrication labor, such as labor to attach, assemble, connect, construct, or fabricate panel systems or components, labor to attach or connect one panel to</u></p>	<p>Comment:</p> <p>This portion of the regulation is basically the same for staff’s proposal and the Installer’s proposal. The proposed language provides that prior to October 1, 1999, contracts to sell and install modular systems furniture are contracts for the sale of tangible personal property and not construction contracts. Such contracts include in the taxable contract price all charges except those excludable from gross receipts or sales price as provided by sections 6011 and 6012. That is, the total contract price is subject to tax except for a minimal amount of installation labor charges and delivery charges meeting the provisions of Regulation 1628.</p>

Regulation 1521 – Construction Contractors *Comparison Between Staff’s Version and the Installer’s Proposed Language*

STAFF’S PROPOSED AMENDMENT	INSTALLER’S PROPOSED CHANGES	COMMENTS
<p><u>labor to attach or connect one panel to another to form workstations or cubicles, and labor to construct or fabricate the individual panels, components, or accessories are subject to tax</u></p> <p><u>For contracts to sell and install modular systems entered into on or after October 1, 1999, 2 percent of the total contract price, excluding charges attributable to free-standing casegoods or free-standing storage items, including desks, credenzas, lateral files, bookcases, worktables, returns, convergents, corner units, storage towers, chairs and footrests, but including all other charges, will be presumed to be a charge for labor to install or apply the property sold. Retailers may claim the 2 percent labor deduction in lieu of separately accounting for the actual installation labor charges incurred.</u></p>	<p><u>another to form workstations or cubicles, and labor to construct or fabricate the individual panels, components, or accessories are subject to tax.</u></p>	<p>Staff recommendation proposes that the contracts remain contracts to sell and install tangible personal property. Based on discussions with manufacturers, retailers, related associations, and other interested parties, staff found that contracts within the industry are generally for a delivered price with the total contract amount included in the reported taxable sales price. Although a minimal amount of exempt installation labor is incurred, retailers generally do not separately account for such charges due to the accounting difficulties encountered. As also advised by many of the retailers, most labor charges incurred are for the assembly and setup of the systems. As provided by statute, such charges are taxable. Staff proposes for ease of reporting and to provide for the minimal amount of exempt installation labor incurred, that the regulation be amended to provide a 2% standard installation labor deduction in lieu of the retailer maintaining separate records to support the amounts claimed.</p>

Regulation 1521 – Construction Contractors *Comparison Between Staff’s Version and the Installer’s Proposed Language*

STAFF’S PROPOSED AMENDMENT	INSTALLER’S PROPOSED CHANGES	COMMENTS
	<p><u>A contract to furnish and install panelized office systems entered into on or after October 1, 1999, which requires the permanent attachment of panels and components to realty, regardless of the order, manner, or method of attachment, is deemed a construction contract and the system a fixture when installed. When the construction contractor is a United States construction contractor, tax applies as provided in (b)(1). For construction contractors other than United States construction contractors tax applies as provided in subdivision (b)(2)(B)2. Notwithstanding any other provisions of this regulation, when the contract does not state the sales price, the sales price is deemed to be 85% of the total contract price, excluding charges attributable to free-standing casegoods or free-standing storage items, including desks, credenzas, lateral files, bookcases, worktables, returns, convergents, corner units, storage towers, chairs and footrests, but including all other charges.</u></p>	<p>The installer’s proposal regards the systems as fixtures when installed and the contracts, construction contracts. As proposed by the installers, the regulatory language provides nontaxable treatment of the labor and service charges to install, assemble, deliver, setup, and layout the modular systems. According to the installers, the systems are believed to qualify as fixtures pursuant to California Civil Code section 660. Labor to install, assemble, etc., is believed to be somewhere between ten to twenty percent of the total contract price. On average, the installers believe fifteen percent to be representative. Deeming the “sales price” of the fixture to be 85% provides for the standard 15%. As the systems are believed to be fixtures, the associated labor charges should all be considered exempt installation charges, as the installers believe is true of all construction contracts.</p> <p>Deeming the “sales price” to be 85% results in various taxable charges, i.e., assembly labor, layout, and some delivery charges, being treated as nontaxable.</p>

Formal Issue Paper Number 99–006 (3/99)
Comparison Table

Regulation 1521 – Construction Contractors *Comparison Between Staff’s Version and the Installer’s Proposed Language*

STAFF’S PROPOSED AMENDMENT	INSTALLER’S PROPOSED CHANGES	COMMENTS
<u>A contract to furnish and install wall panels or demountable wall units, so that they are firmly affixed and fastened to the floor and to the ceiling of a building or structure so as to lose their identity as panels and become an integral and inseparable part of the realty, is a construction contract. Such wall panels or demountable wall units are materials, and tax applies as provided in subdivision (b).</u>	<u>A contract to furnish and install wall panels or demountable wall units, so that they are firmly affixed and fastened to the floor and to the ceiling of a building or structure so as to lose their identity as panels and become an integral and inseparable part of the realty, is a construction contract. Such wall panels or demountable wall units are materials, and tax applies as provided in subdivision (b).</u>	This portion of the installer’s proposal is consistent with staff’s recommendation. Both provide that floor-to-ceiling panels that are firmly affixed and incorporated into the realty are materials and that portion of the contract, a contract for the sale and installation of materials.
		g:/issue/1521comp.doc

Regulation 1521. Construction Contractors.

(a) Definitions.

(1) Construction Contract.

(A) "Construction contract" means and includes a contract, whether on a lump sum, time and material, cost plus, or other basis, to:

1. Erect, construct, alter, or repair any building or other structure, project, development, or other improvement on or to real property, or

2. Erect, construct, alter, or repair any fixed works such as waterways and hydroelectric plants, steam and atomic electric generating plants, electrical transmission and distribution lines, telephone and telegraph lines, railroads, highways, airports, sewers and sewage disposal plants and systems, waterworks and water distribution systems, gas transmission and distribution systems, pipelines and other systems for the transmission of petroleum and other liquid or gaseous substances, refineries and chemical plants, or

3. Pave surfaces separately or in connection with any of the above works or projects, or

4. Furnish and install the property becoming a part of a central heating, air-conditioning, or electrical system of a building or other structure, and furnish and install wires, ducts, pipes, vents, and other conduit imbedded in or securely affixed to the land or a structure thereon.

(B) "Construction contract" does not include:

1. A contract for the sale or for the sale and installation of tangible personal property such as machinery and equipment, or

2. The furnishing of tangible personal property under what is otherwise a construction contract if the person furnishing the property is not responsible under the construction contract for the final affixation or installation of the property furnished.

(2) Construction Contractor. "Construction contractor" means any person who for himself or herself, in conjunction with, or by or through others, agrees to perform and does perform a construction contract. "Construction contractor" includes subcontractors and specialty contractors and those engaged in such building trades as carpentry, bricklaying, cement work, steel work, plastering, drywall installation, sheet metal work, roofing, tile and terrazzo work, electrical work, plumbing, heating, air-conditioning, elevator installation and construction, painting, and persons installing floor coverings, including linoleum, floor tile, and wall-to-wall carpeting, by permanently affixing such coverings to a floor. "Construction contractor" includes any person required to be licensed under the California Contractors' State License Law (Business & Professions Code Sections 7000 et seq.); ~~and any person contracting with the United States to perform a construction contract,~~ whether such persons is ~~are~~ formed or organized under the laws of this state, or another state or country.

(3) United States Construction Contractor. "United States construction contractor" means a construction contractor who for himself or herself, in conjunction with, or by or through others, agrees to perform and does perform a construction contract for the United States Government, whether such person is formed or organized under the laws of this state, or another state or country.

(4) Materials. "Materials" means and includes construction materials and components, and other tangible personal property incorporated into, attached to, or affixed to, real property by contractors in the performance of a construction contract and which, when combined with other tangible personal property, loses its identity to become an integral and inseparable part of the real property. A list of typical items regarded as materials is set forth in Appendix A.

(5) Fixtures. "Fixtures" means and includes items which are accessory to a building or other structure and do not lose their identity as accessories when installed. A list of typical items regarded as fixtures is set forth in Appendix B.

(6) Machinery and Equipment. "Machinery and equipment" means and includes property intended to be used in the production, manufacturing or processing of tangible personal property, the performance of services or for other purposes (e.g., research, testing, experimentation) not essential to the fixed works, building, or structure itself, but which property incidentally may, on account of its nature, be attached to the realty without losing its identity as a particular piece of machinery or equipment and, if attached, is readily removable without damage to the unit or to the realty. "Machinery and equipment" does not include junction boxes, switches, conduit and wiring, or valves, pipes, and tubing incorporated into fixed works, buildings, or other structures, whether or not such items are used solely or partially in connection with the operation of machinery and equipment, nor does it include items of tangible personal property such as power shovels, cranes, trucks, and hand or power tools used to perform the construction contract. A list of typical items regarded as machinery and equipment together with a list of typical items not regarded as machinery and equipment is set forth in Appendix C.

(7) Time and Material Contract. "Time and material contract" means a contract under which the contractor agrees to furnish and install materials or fixtures, or both, and which sets forth separately a charge for the materials or fixtures and a charge for their installation or fabrication.

(8) Lump Sum Contract. "Lump sum contract" means a contract under which the contractor for a stated lump sum agrees to furnish and install materials or fixtures, or both. A lump sum contract does not become a time and material contract when the amounts attributable to materials, fixtures, labor, or tax are separately stated in the invoice.

(b) Application Of Tax.

(1) United States Construction Contractors.

(A) Materials and Fixtures. United States construction contractors are consumers of materials and fixtures which they furnish and install in the performance of contracts with the United States Government. Either the sales tax or the use tax applies with respect to sales of tangible personal property (including materials, fixtures, supplies, and equipment) to contractors for use in the performance

of such contracts with the United States for the construction of improvements on or to real property in this state. The fact that the contract may provide principally for the manufacture or acquisition of tangible personal property is immaterial. The sales tax, but not the use tax, applies even though the contractor purchases the property as the agent of the United States.

(B) Machinery and Equipment. United States contractors are retailers of machinery and equipment furnished in connection with the performance of a construction contract with the United States Government. Tax does not apply to sales of machinery and equipment to United States contractors or subcontractors, provided title to the property passes to the United States before the contractor makes any use of it. Such sales are sales for resale, and the purchasing contractor may issue a resale certificate. A contractor who uses the machinery or equipment before title passes to the United States is the consumer of that machinery or equipment and either sales tax or use tax applies with respect to the sale to or the use by the contractor.

(2) Construction Contractors Other than United States Construction Contractors.

(A) Materials.

1. In General. Construction contractors are consumers of materials which they furnish and install in the performance of construction contracts. Either sales tax or use tax applies with respect to the sale of the materials to or the use of the materials by the construction contractor.

2. When Contractor is Seller. A construction contractor may contract to sell materials and also to install the materials sold. If the contract explicitly provides for the transfer of title to the materials prior to the time the materials are installed, and separately states the sale price of the materials, exclusive of the charge for installation, the contractor will be deemed to be the retailer of the materials.

In the case of a time and material contract, if the contractor bills his or her customer an amount for "sales tax" computed upon his or her marked up billing for materials, it will be assumed, in the absence of convincing evidence to the contrary, that he or she is the retailer of the materials.

If the sale occurs in this state, the sales tax applies to the contractor's (retailer's) gross receipts from the sale of the materials. If the sale occurs prior to the time the property is brought into this state, the contractor's (retailer's) customer is the consumer and his or her use (unless otherwise exempt) is subject to use tax measured by the sales price. The contractor must collect the use tax and pay it to this state.

(B) Fixtures.

1. In General. Construction contractors are retailers of fixtures which they furnish and install in the performance of construction contracts and tax applies to their sales of the fixtures.

2. Measure of Tax.

a. In General. If the contract states the sale price at which the fixture is sold, tax applies to that price. If the contract does not state the sale price of the fixture, the sale price shall be deemed to be the cost price of the fixture to the contractor.

b. Determining Cost Price. If the contractor purchases the fixtures in a completed condition, the cost price is deemed to be the sale price of the fixture to him or her and shall include any manufacturer's excise tax or import duty imposed with respect to the fixture prior to its sale by the contractor.

If the contractor is the manufacturer of the fixture, the cost price is deemed to be the price at which similar fixtures in similar quantities ready for installation are sold by him or her to other contractors.

If similar fixtures are not sold to other contractors ready for installation, then the cost price shall be deemed to be the amount stated in the price lists, bid sheets or other records of the contractor.

If the sale price cannot be established in the above manner and the fixture is manufactured by the contractor, the cost price shall be deemed to be the aggregate of the following:

- 1] Cost of materials, including such items as freight-in and import duties,
- [2] Direct labor, including fringe benefits and payroll taxes,
- [3] Specific factory costs attributable to the fixture,
- [4] Any manufacturer's excise tax,
- [5] Pro rata share of all overhead attributable to the manufacture of the fixture, and
- [6] Reasonable profit from the manufacturing operations which, in the absence of evidence to the contrary, shall be deemed to be 5 percent of the sum of the preceding factors.

Jobsite fabrication labor and its prorated share of manufacturing overhead must be included in the sale price of the fixture. Jobsite fabrication labor includes assembly labor performed prior to attachment of a component or a fixture to a structure or other real property.

3. Exceptions - Leased Fixtures. In some instances the construction contractor may furnish and install a fixture for a person, other than the owner of the realty, who intends to lease the fixture in place as tangible personal property as provided in Section 6016.3 of the Revenue and Taxation Code and pay tax measured by rental receipts.

In this case the construction contractor may take a resale certificate from the lessor at the time of the transaction and the sale to the lessor will be considered to be a sale for resale. The resale certificate should indicate that the fixture is purchased for resale by the purchaser as tangible personal property under Section 6016.3 of the Revenue and Taxation Code.

(C) Machinery and Equipment.

1. In General. Construction contractors are retailers of machinery and equipment even though the machinery and equipment is furnished in connection with a construction contract. Tax applies to the contractor's gross receipts from such sales.

2. Measure of Tax.

a. In General. Tax applies to the gross receipts from the sale of machinery and equipment furnished and installed by a construction contractor. If the contract calls only for the furnishing and installation of machinery and equipment, tax applies to the total contract price less those charges excludible from gross receipts under Section 6012 of the Revenue and Taxation Code.

b. Lump Sum Contracts - Determining Gross Receipts. If the contract is for a lump sum and includes the furnishing and installation of materials, fixtures, and machinery and equipment, the gross receipts from the sale of the machinery and equipment shall be the price at which similar quantities ready for installation are sold at retail delivered in the market area where the installation takes place.

If there is no such retail price for the machinery and equipment, then the gross receipts shall be determined from the contracts, price lists, bid sheets, or other records of the contractor.

If the gross receipts cannot be established in the above manner and the machinery and equipment is manufactured by the contractor, the gross receipts from the sale shall be the aggregate of the following:

- [1] Cost of materials, including such items as freight-in and import duties,
- [2] Direct labor, including fringe benefits and payroll taxes,
- [3] Specific factory costs attributable to the machinery or equipment,
- [4] Any manufacturer's excise tax,
- [5] Pro rata share of all overhead attributable to the machinery or equipment, including overhead attributable to manufacturing, selling, contracting, and administration, and
- [6] Reasonable profit from the manufacture and sale of the machinery or equipment which, in the absence of evidence to the contrary, shall be deemed to be 5 percent of the sum of the preceding factors.

Jobsite fabrication labor and its prorated share of manufacturing overhead must be included in the sale price of the machinery or equipment. Jobsite fabrication labor includes assembly labor performed prior to attachment of a component or the machinery or equipment to a structure or other real property.

(D) Cost Plus A Fee Contracts. When a contractor enters into a construction contract for a cost plus a fee or time and materials plus a fee, whether the fee is a lump sum or a percentage of costs, the fee is not included in the measure of tax. When the contractor is the manufacturer of the fixtures or machinery and equipment, the "cost price" of the fixtures and the gross receipts from the sale of the machinery and equipment shall be determined in accordance with (B) and (C) above.

(3) Miscellaneous Sales by Contractors. In addition to sales of fixtures and machinery and equipment, tax applies to all retail sales by contractors of tangible personal property, including parts, supplies, tools, construction equipment, buildings severed or to be severed by the contractor, and furniture, including furniture sold with a building, even though the building is sold "in place."

(4) Permits. Contractors engaged solely in performing construction contracts which do not

involve the sale and installation of fixtures and who do not also engage in business as sellers or retailers are not required to hold seller's permits. However, if a contractor is a seller or retailer because he or she makes sales of fixtures, materials, or machinery and equipment, or other tangible personal property either in connection with or as part of a construction contract, or otherwise, he or she is required to hold a seller's permit.

(5) Supplies and Tools for Self-Use. Contractors are the consumers of supplies such as oxygen, acetylene, gasoline, acid, thread-cutting oil, and tools and parts for tools, which they use in their business, and the tax applies to the sale of such supplies and tools to contractors.

6) Exemption Certificates.

(A) Resale Certificates. Contractors holding valid seller's permits may purchase fixtures and machinery and equipment for resale by issuing resale certificates to their suppliers. They may not purchase materials for resale unless they are also in the business of selling materials.

A contractor cannot avoid liability for sales or use tax on materials or fixtures furnished and installed by him or her by taking a resale certificate from the prime contractor, interior decorators, designers, department stores, or others. However, under the circumstances described in subsection (b)(2)(B)3., a contractor may take a resale certificate for fixtures furnished and installed by him or her for a person other than the owner of the realty.

(B) Exemption Certificates for Out-of-State Use. Sales tax does not apply to sales of tangible personal property to a construction contractor who holds a valid California seller's permit when the property is used by the contractor outside this state in his or her performance of a contract to improve real property and as a result of such use the property is incorporated into and becomes a part of real property located outside this state. This exemption is available only if at the time of the purchase the contractor certifies in writing to the seller that he or she holds a valid California seller's permit (giving the number of that permit and identifying the property purchased) and states that the property will be used in the manner stated above. The certificate must be signed by the contractor or an authorized employee. Such a certification may appear in the body of a purchase order which bears the signature of the purchaser. Any certificate given subsequent to the time of purchase will not be recognized.

If the property purchased under a certificate is used by the contractor in any other manner or for any other purpose than stated in the certificate, the contractor shall be liable for sales tax as if he or she were a retailer making a retail sale of the property at the time of such use, and the sale price of the property to him or her shall be deemed the gross receipts from the sale.

(C) Deductions for Tax-Paid Purchases Resold. A contractor may claim a "tax-paid purchases resold" deduction for any property of which he or she is the retailer when he or she has reimbursed his or her vendor for tax which the vendor is required to pay to the State or has paid the use tax with respect to the property, and has resold the property prior to making any use of it. In the event that the contractor sells short ends or pieces which are not used other than in severing them from larger units purchased by him or her and as to which he or she has paid sales tax reimbursement or use tax, he or she may claim the deduction for tax-paid purchases resold, but the amount of the deduction shall not exceed the price at which he or she sells such short ends or pieces.

(c) Particular Applications.

(1) Draperies and Drapery Hardware. Persons who contract to sell and install draperies including drapery hardware, such as brackets, rods, tracks, etc., are retailers of the items which they furnish and install. Tax applies to the entire contract price exclusive of the charge for installation which charge should be separately stated. Installers who furnish drapery hardware or other tangible personal property may accept resale certificates from department stores or other sellers to furnish and install the draperies and drapery hardware.

The department stores or other sellers furnishing resale certificates are required to pay the tax to the state upon their selling price of the draperies and drapery hardware, exclusive of installation charges. The installer should segregate his or her installation charge in order that the department store or other seller may properly segregate its charge attributable to installation for purposes of determining its taxable gross receipts.

(2) Prefabricated Cabinets. A cabinet will be considered to be "prefabricated" and a "fixture" when 90 percent of the total direct cost of labor and material in fabricating and installing the cabinet is incurred prior to affixation to the realty. In determining this 90 percent, the total direct cost of all labor and materials in fabricating the cabinet to the point of installation will be compared to the total direct cost of all labor and materials in completely fabricating and installing the cabinet. If more than one cabinet is fabricated and installed under the contract, each cabinet will be considered separately in determining whether the cabinet is prefabricated.

(3) Prefabricated Buildings. Prefabricated units such as commercial coaches, house trailers, etc., registered with the Department of Motor Vehicles or the Department of Housing and Community Development, are tangible personal property even though they may be connected to plumbing and utilities. A mobilehome which meets or is modified to meet, all applicable building codes and regulations and which is permanently affixed to realty, is an improvement to realty and is not personal property.

A contract to furnish and install a prefabricated or modular building similar in size to, but which is not, a factory-built school building (relocatable classroom) is a construction contract whether the building rests in place by its own weight or is physically attached to realty. It is immaterial whether the building is erected upon or affixed to land owned by the owner of the building or is leased to the landowner or lessee of the land.

Generally, a contract to furnish and install a small prefabricated building, such as a shed or kiosk, which is movable as a unit from its site of installation, is a construction contract only if the building is required to be physically attached to real property by the seller, upon a concrete foundation or otherwise. The sale of such a unit to rest in place by its own weight, whether upon the ground, a concrete slab, or sills or piers, is not a construction contract even though the seller may deliver the unit to its site of use.

Prefabricated or modular buildings which are "factory-built housing" where permanently affixed to the realty are improvements to realty. The manufacturer of factory-built housing who contracts to furnish and install the factory-built housing manufactured by him or her is the consumer of the materials used in building and installing the factory-built housing and the retailer of the fixtures. Tax applies as provided in (b) above.

(4) Factory-Built School Buildings.

(A) General. On and after September 26, 1989, a contract to furnish and install a factory-built school building is not a construction contract but rather is a sale of tangible personal property.

(B) Definitions.

1. "Factory-built School Building." The term "factory-built school building" (relocatable classrooms) means and includes:

A. for the period September 26, 1989 through September 12, 1990, any building designed to be used as a school building as defined in Sections 39214 and 81165 of the Education Code and so used. A factory-built school building must be designed in compliance with state laws for school construction and approved by the structural safety section in the office of the State Architect. It must be wholly or substantially manufactured at an offsite location for the purpose of being assembled, erected, or installed on a schoolsite.

B. effective September 13, 1990, any building which is designed or intended for use as a school building and is wholly or substantially manufactured at an offsite location for the purpose of being assembled, erected, or installed on a site owned or leased by a school district or a community college district. A factory-built school building must be designed and manufactured in accordance with building standards adopted and approved pursuant to Chapter 4 (commencing with Section 18935) of Part 2.5 of Division 13 of the Health and Safety Code and must be approved by the structural safety section in the office of the State Architect.

The term does not include buildings licensed by either the Department of Motor Vehicles or the Department of Housing and Community Development. The term also does not include prefabricated or modular buildings which are similar in size to, but which are not, "factory-built school buildings". It is immaterial whether the building is erected upon or affixed to land owned by the owner of the building or is leased to the landowner or lessee of the land.

2. "Consumer."

A. For the period September 26, 1989 through September 12, 1990, the term "consumer" as used herein means either (1) a school or a school district or (2) a contractor who purchases a factory-built school building for the purpose of fulfilling the requirements of an existing contract with a school or school district to furnish and install such building.

B. Effective September 13, 1990, the term "consumer" as used herein means either (1) a school district or a community college district or (2) a contractor who purchases a factory-built school building for the purpose of fulfilling the requirements of an existing contract with a school district or a community college district to furnish and install such building.

(C) Place of Sale. The place of sale or purchase of a factory-built school building is the place of business of the retailer regardless of whether the sale of the building includes installation or whether the building is placed upon a permanent foundation.

(D) Application of Tax.

1. Tax applies to 40 percent of the sales price of the building to the consumer excluding any charges for placing the completed building on the site. The sales price of the building shall include amounts representing tangible personal property installed in the building by a subcontractor, whether prior to or after installation of the building at the site, provided such installation is called for in the prime contract for the building. A separate contract to furnish and install tangible personal property in a factory-built school building after installation of the building at the site is a construction contract and tax applies as in (b) above. Any contract or subcontract for site preparation (e.g., foundation) is a construction contract and tax applies as in (b) above.

2. The sale of a factory-built school building to a purchaser who will resell the building without installation is a sale for resale and the seller may accept a resale certificate from the purchaser. If the purchaser then sells to a contractor who has an existing contract to install the building on a school site, tax will apply as in (c)(4)(D)l. above. If tax has been paid on the purchase price of a factory-built school building which is subsequently resold for installation, a tax-paid purchases resold deduction may be taken as provided in Regulation 1701 (18 CCR 1701).

(E) Exclusion Certificate. For the period September 26, 1989, through September 12, 1990, if the purchaser certifies in writing to the retailer that the factory built school building purchased will be consumed in a manner or for a purpose entitling the retailer to exclude 60% of the gross receipts or sales price from the measure of tax and uses the property in some other manner or for some other purpose, the purchaser shall be liable for payment of tax measured by 60% of the sales price. For the above stated period, all retailers who make retail sales of "factory-built school buildings" claimed to be subject to tax measured by 40 percent of the sales price must obtain from the "consumer" a signed certificate substantially in the form set forth below.

CLAIM FOR 60% EXCLUSION FROM TAX ON
PURCHASE OF FACTORY-BUILT SCHOOL BUILDINGS
(Sec. 6012.6, Rev. & Tax. Code)

I hereby certify that the factory-built school building that I

(Name of Purchaser-Consumer)

am purchasing under the authority of this certificate from

(Name of Retailer)

will be used as a school building as defined in Sales and Use Tax Regulation 1521. My
seller's permit number, if any, is_____.

I further certify that I understand and agree that if the property purchased under the authority
of this certificate is used by the purchaser for any purpose other than indicated above, the
purchaser shall be liable for payment of tax to the State Board of Equalization at the time of
such use measured by 60% of the sales price of the factory-built school building.

Signed by_____
(Name of Purchaser)

As:_____
(Owner, Partner, Purchasing Agent, etc.)

Date_____

(5) Mobilehomes Installed for Occupancy as Residences. Operative July 1, 1980, a special
measure of sales or use tax is provided for a mobilehome sold to be affixed to realty for occupancy as
a residence.

A mobilehome dealer who sells a new mobilehome to a construction contractor to be affixed to land
for occupancy as a residence is the "retailer-consumer" of the property and is required to pay tax for
the period in which the sale was made by the dealer measured by an amount equal to 75 percent of the
retailer-consumer's purchase price of the mobilehome.

A construction contractor who withdraws a new mobilehome from an inventory purchased for resale
to be affixed to realty for occupancy as a residence in the performance of a construction contract is
required to pay tax measured by 75 percent of the purchase price by his or her mobilehome vendor
except where the purchase is made directly from a mobilehome manufacturer. In the absence of
satisfactory evidence of the vendor's purchase price it shall be presumed that the measure of tax for
the transaction is an amount equivalent to 60 percent of the sales price of the mobilehome to the
construction contractor.

A mobilehome manufacturer who sells a new mobilehome directly to a construction contractor for

installation to real property for occupancy as a residence is required to pay tax measured by 75 percent of the sales price at which a similar mobilehome ready for installation would be sold by the manufacturer to a retailer-consumer in this state. A construction contractor who withdraws a new mobilehome from an inventory purchased from a manufacturer for resale must pay tax measured by 75 percent of his or her purchase price.

A mobilehome manufacturer who performs a construction contract by permanently affixing a new mobilehome to real property is the consumer of the material and the retailer of fixtures installed by him or her and the tax applies as set forth in paragraph (b) above.

Reference should also be made to the provisions of Regulation 1610.2 for additional interpretative rules relating to custom additions to the mobilehome prior to sale, transfers of nonvehicle items, and the application of the tax to a purchase made from an out-of-state retailer.

(6) Repair Contracts. A contract to repair a fixture in place or a fixture the contractor is required by the contract to reattach to the realty is a construction contract. Sales or use tax applies to the gross receipts or sales price of the parts sold by a contractor who is a retailer under this provision. Either sales tax or use tax applies to the sales price of the parts sold to or used by a contractor who is a consumer under this provision.

(A) United States Construction Contractors. A United States construction contractor is the consumer of the parts furnished in the performance of a construction contract to repair a fixture.

(B) Construction Contractors Other Than United States Construction Contractors.

1. A contractor is the retailer of the parts furnished in the performance of a construction contract to repair a fixture when the sale price of the parts is billed separately from the repair labor.

2. A contractor is the consumer of the parts furnished in the performance of a lump sum construction contract to repair a fixture.

(7) Elevator Installations. A large number of components are included in the installation of an elevator system. Those portions constituting the cage or platform and its hoisting machinery are fixtures. The balance of the installation, if attached to a structure or other real property will generally be "materials."

Similarly, installation of escalators and moving sidewalks are in part fixtures and in part materials.

Following are examples of components constituting part of the cage or platform and its hoisting machinery, and which are fixtures:

alarm bell	door operator on cab or car	power units and control boxes
cab or car	door safety edge on cab	pumps
car doors	door sills on cab	pushbuttons on cab
car platform and sling	electronic door protector	wire and piping (which are
door hanger on cab	jack assembly	components of a fixture)

Following are examples of components constituting “materials” when attached to realty:		
car guides	hoistway door sills and jams	sound insulating panels on “materials”
casing section of jack assembly	hoistway door supports	structural steel (unless part of cab, car, or other “fixture”)
guide rails	hoistway entrance	
hoistway doors	pushbuttons on hoistway	
hoistway door frames	rail buckets	
hoistway door safety edge	sill, struts	
		valve strainer
		wire and piping attached to “materials”

Following are examples of components constituting parts of escalators or moving sidewalks which are fixtures:

staircase	chains	other operating mechanisms
moving sidewalk	sprockets	
moving handrails	motors	

(8) Telephone Switchboards and Instruments. Telephone switching equipment installed in a building specifically designed to accommodate the equipment or attached to a building or structure in a manner such that its removal would cause damage to the equipment or building in which it is installed will be considered to be “fixtures” under paragraph (a)(5) of this regulation.

Telephone handsets, modular switching equipment and standardized, off-shelf, general purpose switching equipment sold for use in general purpose office buildings constitute machinery and equipment under paragraph (a)(6) of this regulation. Handsets, modular switching equipment and standardized equipment were previously classified as fixtures.

This change in classification shall be applied prospectively only with respect to construction contracts entered into on and after July 1, 1988, by contractors other than United States construction contractors.

(9) **Deep-Well Agricultural Pumps.** A deep-well agricultural pump is tangible personal property if installed so that it rests in position by force of gravity and is not otherwise affixed to the land.

The pump is a fixture if:

- (A) It is affixed to the land such as by concrete, bolts or screws,
- (B) It is physically connected to an irrigation system such as by pipes or couplings so as to become an integral part of the system, or
- (C) It is enclosed by a pump house or other building or structure .

(10) Remote Control Garage Door Openers. Remote control garage door opening units are fixtures. Portable transmitter units furnished pursuant to a construction contract are deemed to be fixtures and are taxable as provided in subdivision (b)(2)(B). Sales of portable transmitter units not a part of a construction contract, as, for example, sales of replacement units, are retail sales of tangible personal

property and subject to tax as such.

(11) Modular Systems Furniture. Modular systems furniture is tangible personal property, whether or not affixed to realty. A contract to furnish sell and install modular systems furniture is a contract for the sale of tangible personal property and is not a construction contract. Persons who contract to sell and install modular systems furniture are retailers of the items which they furnishsell and install, and tax applies to the entire contract price exclusive of the charge for installation labor less those charges excludable from gross receipts or sales price pursuant to Sections 6011 and 6012 of the Revenue and Taxation Code. Retailers who claim a deduction for installation labor such charges should maintain complete and detailed records to support the amounts claimed. Such records should include, but not be limited to, a separate accounting of charges for installation labor, such as labor to affix, bolt, fasten, or hardwire panels to realty and labor to fasten or affix fully constructed components to fully constructed panel systems or other components. Charges for fabrication labor, such as labor to attach, assemble, connect, construct, or fabricate panel systems or components, labor to attach or connect one panel to another to form workstations or cubicles, and labor to construct or fabricate the individual panels, components, or accessories are subject to tax.

Operative July 1, 1999, For contracts to furnish sell and install modular systems entered into on or after that date October 1, 1999, 2 percent of the total contract price, excluding charges attributable to free-standing casegoods or free-standing storage items, including desks, credenzas, lateral files, bookcases, worktables, returns, convergents, corner units, storage towers, chairs and footrests, but including all other charges, will be presumed to be a charge for labor to install or apply the property sold. Retailers may claim the 2 percent labor deduction in lieu of separately accounting for the actual installation labor charges incurred.

A contract to furnish and install wall panels or demountable wall units, so that they are firmly affixed and fastened to the floor and to the ceiling of a building or structure so as to lose their identity as panels and become an integral and inseparable part of the realty, is a construction contract. Such wall panels or demountable wall units are materials, and tax applies as provided in subdivision (b).

(142) Excess Reimbursement. The excess tax reimbursement provisions of Regulation 1700 apply to construction contractors.

Appendix A The following is a list of typical items regarded as materials:

Asphalt	Linoleum	Steel
Bricks	Lumber	Stone
Builders' hardware	Macadam	Stucco
Caulking material	Millwork	Tile
Cement	Mortar	Wall coping
Conduit	Oil	Wallboard
Doors	Paint	Wallpaper
Ducts	Paper	Wall-to-wall carpeting
Electric wiring and connections	Piping, valves, and pipe fittings	(when affixed to the floor)
Flooring	Plaster	Weather stripping

Glass	Power poles, towers, and lines	Windows
Gravel	Putty	Window screens
Insulation	Reinforcing mesh	Wire netting and screen
Lath	Roofing	Wood preserver
Lead	Sand	
Lime	Sheet metal	

Appendix B The following is a list of typical items regarded as fixtures:

Air conditioning units	Furnaces, boilers, and heating units
Awnings	Lighting fixtures
Burglar alarm and fire alarm fixtures	Plumbing fixtures
Cabinets, counters, and lockers (prefabricated)	Refrigeration units
Cranes ¹ (including moving parts of cranes) affixed or annexed to a building, structure or fixed work	Signs
Electric generators (affixed to and accessory to a building, structure or fixed works)	Television antennas
Elevators, hoists, and conveying units	Transformers and switchgear
	Vault doors and equipment
	Venetian blinds

¹Moving parts of cranes are classified as machinery and equipment when furnished and installed pursuant to fixed price construction contracts entered into prior to July 1, 1985.

Appendix C The following are lists of typical items regarded as:

Machinery and Equipment	Not Machinery or Equipment
Drill presses	Fixtures and materials as defined in this regulation
Electric generators (unaffixed, or, if affixed, which meet the requirements of subparagraph (a)(6))	Wiring, piping, etc., used as a source of power, water, etc., for machinery and equipment
Lathes	Radio transmission antennas
Machine tools	Large tanks (i.e., over 500 barrel capacity)
Printing presses	Fire alarm systems
	Street light standards
	Cooling towers other than small prefabricated cooling units

Note: Authority: Section 7051, Revenue and Taxation Code

Reference: Sections 6006 - 6010, 6012, 6012.2., 6012.6, 6012.8, 6012.9, 6015, 6016,
6016.3, 6016.5, 6055, 6091-6095, 6203.5, 6241-6246, 6276, 6276.1, 6379,
6384, 6386, 6421, 6901.5, Revenue and Taxation Code.

Regulation 1521. Construction Contractors.

(a) Definitions.

(1) Construction Contract.

(A) "Construction contract" means and includes a contract, whether on a lump sum, time and material, cost plus, or other basis, to:

1. Erect, construct, alter, or repair any building or other structure, project, development, or other improvement on or to real property, or

2. Erect, construct, alter, or repair any fixed works such as waterways and hydroelectric plants, steam and atomic electric generating plants, electrical transmission and distribution lines, telephone and telegraph lines, railroads, highways, airports, sewers and sewage disposal plants and systems, waterworks and water distribution systems, gas transmission and distribution systems, pipelines and other systems for the transmission of petroleum and other liquid or gaseous substances, refineries and chemical plants, or

3. Pave surfaces separately or in connection with any of the above works or projects, or

4. Furnish and install the property becoming a part of a central heating, air-conditioning, or electrical system of a building or other structure, and furnish and install wires, ducts, pipes, vents, and other conduit imbedded in or securely affixed to the land or a structure thereon.

(B) "Construction contract" does not include:

1. A contract for the sale or for the sale and installation of tangible personal property such as machinery and equipment, or

2. The furnishing of tangible personal property under what is otherwise a construction contract if the person furnishing the property is not responsible under the construction contract for the final affixation or installation of the property furnished.

(2) Construction Contractor. "Construction contractor" means any person who for himself or herself, in conjunction with, or by or through others, agrees to perform and does perform a construction contract. "Construction contractor" includes subcontractors and specialty contractors and those engaged in such building trades as carpentry, bricklaying, cement work, steel work, plastering, drywall installation, sheet metal work, roofing, tile and terrazzo work, electrical work, plumbing, heating, air-conditioning, elevator installation and construction, painting, and persons installing floor coverings, including linoleum, floor tile, and wall-to-wall carpeting, by permanently affixing such coverings to a floor. "Construction contractor" includes any person required to be licensed under the California Contractors' State License Law (Business & Professions Code Sections 7000 et seq.); ~~and any person contracting with the United States to perform a construction contract,~~ whether such persons is are formed or organized under the laws of this state, or another state or country.

(3) United States Construction Contractor. “United States construction contractor” means a construction contractor who for himself or herself, in conjunction with, or by or through others, agrees to perform and does perform a construction contract for the United States Government, whether such person is formed or organized under the laws of this state, or another state or country.

(4) Materials. “Materials” means and includes construction materials and components, and other tangible personal property incorporated into, attached to, or affixed to, real property by contractors in the performance of a construction contract and which, when combined with other tangible personal property, loses its identity to become an integral and inseparable part of the real property. A list of typical items regarded as materials is set forth in Appendix A.

(5) Fixtures. “Fixtures” means and includes items which are accessory to a building or other structure and do not lose their identity as accessories when installed. A list of typical items regarded as fixtures is set forth in Appendix B.

(6) Machinery and Equipment. “Machinery and equipment” means and includes property intended to be used in the production, manufacturing or processing of tangible personal property, the performance of services or for other purposes (e.g., research, testing, experimentation) not essential to the fixed works, building, or structure itself, but which property incidentally may, on account of its nature, be attached to the realty without losing its identity as a particular piece of machinery or equipment and, if attached, is readily removable without damage to the unit or to the realty. “Machinery and equipment” does not include junction boxes, switches, conduit and wiring, or valves, pipes, and tubing incorporated into fixed works, buildings, or other structures, whether or not such items are used solely or partially in connection with the operation of machinery and equipment, nor does it include items of tangible personal property such as power shovels, cranes, trucks, and hand or power tools used to perform the construction contract. A list of typical items regarded as machinery and equipment together with a list of typical items not regarded as machinery and equipment is set forth in Appendix C.

(7) Time and Material Contract. “Time and material contract” means a contract under which the contractor agrees to furnish and install materials or fixtures, or both, and which sets forth separately a charge for the materials or fixtures and a charge for their installation or fabrication.

(8) Lump Sum Contract. “Lump sum contract” means a contract under which the contractor for a stated lump sum agrees to furnish and install materials or fixtures, or both. A lump sum contract does not become a time and material contract when the amounts attributable to materials, fixtures, labor, or tax are separately stated in the invoice.

(b) Application Of Tax.

(1) United States Construction Contractors.

(A) Materials and Fixtures. United States construction contractors are consumers of materials and fixtures which they furnish and install in the performance of contracts with the United States Government. Either the sales tax or the use tax applies with respect to sales of tangible personal

property (including materials, fixtures, supplies, and equipment) to contractors for use in the performance of such contracts with the United States for the construction of improvements on or to real property in this state. The fact that the contract may provide principally for the manufacture or acquisition of tangible personal property is immaterial. The sales tax, but not the use tax, applies even though the contractor purchases the property as the agent of the United States.

(B) Machinery and Equipment. United States contractors are retailers of machinery and equipment furnished in connection with the performance of a construction contract with the United States Government. Tax does not apply to sales of machinery and equipment to United States contractors or subcontractors, provided title to the property passes to the United States before the contractor makes any use of it. Such sales are sales for resale, and the purchasing contractor may issue a resale certificate. A contractor who uses the machinery or equipment before title passes to the United States is the consumer of that machinery or equipment and either sales tax or use tax applies with respect to the sale to or the use by the contractor.

(2) Construction Contractors Other than United States Construction Contractors.

(A) Materials.

1. In General. Construction contractors are consumers of materials which they furnish and install in the performance of construction contracts. Either sales tax or use tax applies with respect to the sale of the materials to or the use of the materials by the construction contractor.

2. When Contractor is Seller. A construction contractor may contract to sell materials and also to install the materials sold. If the contract explicitly provides for the transfer of title to the materials prior to the time the materials are installed, and separately states the sale price of the materials, exclusive of the charge for installation, the contractor will be deemed to be the retailer of the materials.

In the case of a time and material contract, if the contractor bills his or her customer an amount for "sales tax" computed upon his or her marked up billing for materials, it will be assumed, in the absence of convincing evidence to the contrary, that he or she is the retailer of the materials.

If the sale occurs in this state, the sales tax applies to the contractor's (retailer's) gross receipts from the sale of the materials. If the sale occurs prior to the time the property is brought into this state, the contractor's (retailer's) customer is the consumer and his or her use (unless otherwise exempt) is subject to use tax measured by the sales price. The contractor must collect the use tax and pay it to this state.

(B) Fixtures.

1. In General. Construction contractors are retailers of fixtures which they furnish and install in the performance of construction contracts and tax applies to their sales of the fixtures.

2. Measure of Tax.

a. In General. If the contract states the sale price at which the fixture is sold, tax applies to that price. If the contract does not state the sale price of the fixture, the sale price shall be deemed to be the cost price of the fixture to the contractor.

b. Determining Cost Price. If the contractor purchases the fixtures in a completed condition, the cost price is deemed to be the sale price of the fixture to him or her and shall include any manufacturer's excise tax or import duty imposed with respect to the fixture prior to its sale by the contractor.

If the contractor is the manufacturer of the fixture, the cost price is deemed to be the price at which similar fixtures in similar quantities ready for installation are sold by him or her to other contractors.

If similar fixtures are not sold to other contractors ready for installation, then the cost price shall be deemed to be the amount stated in the price lists, bid sheets or other records of the contractor.

If the sale price cannot be established in the above manner and the fixture is manufactured by the contractor, the cost price shall be deemed to be the aggregate of the following:

- [1] Cost of materials, including such items as freight-in and import duties,
- [2] Direct labor, including fringe benefits and payroll taxes,
- [3] Specific factory costs attributable to the fixture,
- [4] Any manufacturer's excise tax,
- [5] Pro rata share of all overhead attributable to the manufacture of the fixture, and
- [6] Reasonable profit from the manufacturing operations which, in the absence of evidence to the contrary, shall be deemed to be 5 percent of the sum of the preceding factors.

Jobsite fabrication labor and its prorated share of manufacturing overhead must be included in the sale price of the fixture. Jobsite fabrication labor includes assembly labor performed prior to attachment of a component or a fixture to a structure or other real property.

3. Exceptions - Leased Fixtures. In some instances the construction contractor may furnish and install a fixture for a person, other than the owner of the realty, who intends to lease the fixture in place as tangible personal property as provided in Section 6016.3 of the Revenue and Taxation Code and pay tax measured by rental receipts.

In this case the construction contractor may take a resale certificate from the lessor at the time of the transaction and the sale to the lessor will be considered to be a sale for resale. The resale certificate should indicate that the fixture is purchased for resale by the purchaser as tangible personal property under Section 6016.3 of the Revenue and Taxation Code.

(C) Machinery and Equipment.

1. In General. Construction contractors are retailers of machinery and equipment even though the machinery and equipment is furnished in connection with a construction contract. Tax applies to the contractor's gross receipts from such sales.

2. Measure of Tax.

a. In General. Tax applies to the gross receipts from the sale of machinery and equipment furnished and installed by a construction contractor. If the contract calls only for the furnishing and installation of machinery and equipment, tax applies to the total contract price less those charges excludible from gross receipts under Section 6012 of the Revenue and Taxation Code.

b. Lump Sum Contracts - Determining Gross Receipts. If the contract is for a lump sum and includes the furnishing and installation of materials, fixtures, and machinery and equipment, the gross receipts from the sale of the machinery and equipment shall be the price at which similar quantities ready for installation are sold at retail delivered in the market area where the installation takes place.

If there is no such retail price for the machinery and equipment, then the gross receipts shall be determined from the contracts, price lists, bid sheets, or other records of the contractor.

If the gross receipts cannot be established in the above manner and the machinery and equipment is manufactured by the contractor, the gross receipts from the sale shall be the aggregate of the following:

- [1] Cost of materials, including such items as freight-in and import duties,
- [2] Direct labor, including fringe benefits and payroll taxes,
- [3] Specific factory costs attributable to the machinery or equipment,
- [4] Any manufacturer's excise tax,
- [5] Pro rata share of all overhead attributable to the machinery or equipment, including overhead attributable to manufacturing, selling, contracting, and administration, and
- [6] Reasonable profit from the manufacture and sale of the machinery or equipment which, in the absence of evidence to the contrary, shall be deemed to be 5 percent of the sum of the preceding factors.

Jobsite fabrication labor and its prorated share of manufacturing overhead must be included in the sale price of the machinery or equipment. Jobsite fabrication labor includes assembly labor performed prior to attachment of a component or the machinery or equipment to a structure or other real property.

(D) Cost Plus A Fee Contracts. When a contractor enters into a construction contract for a cost plus a fee or time and materials plus a fee, whether the fee is a lump sum or a percentage of costs, the fee is not included in the measure of tax. When the contractor is the manufacturer of the fixtures or machinery and equipment, the "cost price" of the fixtures and the gross receipts from the sale of the machinery and equipment shall be determined in accordance with (B) and (C) above.

(3) Miscellaneous Sales by Contractors. In addition to sales of fixtures and machinery and equipment, tax applies to all retail sales by contractors of tangible personal property, including parts, supplies, tools, construction equipment, buildings severed or to be severed by the contractor, and furniture, including furniture sold with a building, even though the building is sold "in place."

(4) Permits. Contractors engaged solely in performing construction contracts which do not involve the sale and installation of fixtures and who do not also engage in business as sellers or retailers are not required to hold seller's permits. However, if a contractor is a seller or retailer because he or she makes sales of fixtures, materials, or machinery and equipment, or other tangible personal property either in connection with or as part of a construction contract, or otherwise, he or she is required to hold a seller's permit.

(5) Supplies and Tools for Self-Use. Contractors are the consumers of supplies such as oxygen, acetylene, gasoline, acid, thread-cutting oil, and tools and parts for tools, which they use in their business, and the tax applies to the sale of such supplies and tools to contractors.

(6) Exemption Certificates.

(A) Resale Certificates. Contractors holding valid seller's permits may purchase fixtures and machinery and equipment for resale by issuing resale certificates to their suppliers. They may not purchase materials for resale unless they are also in the business of selling materials.

A contractor cannot avoid liability for sales or use tax on materials or fixtures furnished and installed by him or her by taking a resale certificate from the prime contractor, interior decorators, designers, department stores, or others. However, under the circumstances described in subsection (b)(2)(B)3., a contractor may take a resale certificate for fixtures furnished and installed by him or her for a person other than the owner of the realty.

(B) Exemption Certificates for Out-of-State Use. Sales tax does not apply to sales of tangible personal property to a construction contractor who holds a valid California seller's permit when the property is used by the contractor outside this state in his or her performance of a contract to improve real property and as a result of such use the property is incorporated into and becomes a part of real property located outside this state. This exemption is available only if at the time of the purchase the contractor certifies in writing to the seller that he or she holds a valid California seller's permit (giving the number of that permit and identifying the property purchased) and states that the property will be used in the manner stated above. The certificate must be signed by the contractor or an authorized employee. Such a certification may appear in the body of a purchase order which bears the signature of the purchaser. Any certificate given subsequent to the time of purchase will not be recognized.

If the property purchased under a certificate is used by the contractor in any other manner or for any other purpose than stated in the certificate, the contractor shall be liable for sales tax as if he or she were a retailer making a retail sale of the property at the time of such use, and the sale price of the property to him or her shall be deemed the gross receipts from the sale.

(C) Deductions for Tax-Paid Purchases Resold. A contractor may claim a "tax-paid purchases resold" deduction for any property of which he or she is the retailer when he or she has reimbursed his or her vendor for tax which the vendor is required to pay to the State or has paid the use tax with respect to the property, and has resold the property prior to making any use of it. In the event that the contractor sells short ends or pieces which are not used other than in severing them from larger units purchased by him or her and as to which he or she has paid sales tax reimbursement or use tax, he or

she may claim the deduction for tax-paid purchases resold, but the amount of the deduction shall not exceed the price at which he or she sells such short ends or pieces.

(c) Particular Applications.

(1) Draperies and Drapery Hardware. Persons who contract to sell and install draperies including drapery hardware, such as brackets, rods, tracks, etc., are retailers of the items which they furnish and install. Tax applies to the entire contract price exclusive of the charge for installation which charge should be separately stated. Installers who furnish drapery hardware or other tangible personal property may accept resale certificates from department stores or other sellers to furnish and install the draperies and drapery hardware.

The department stores or other sellers furnishing resale certificates are required to pay the tax to the state upon their selling price of the draperies and drapery hardware, exclusive of installation charges. The installer should segregate his or her installation charge in order that the department store or other seller may properly segregate its charge attributable to installation for purposes of determining its taxable gross receipts.

(2) Prefabricated Cabinets. A cabinet will be considered to be "prefabricated" and a "fixture" when 90 percent of the total direct cost of labor and material in fabricating and installing the cabinet is incurred prior to affixation to the realty. In determining this 90 percent, the total direct cost of all labor and materials in fabricating the cabinet to the point of installation will be compared to the total direct cost of all labor and materials in completely fabricating and installing the cabinet. If more than one cabinet is fabricated and installed under the contract, each cabinet will be considered separately in determining whether the cabinet is prefabricated.

(3) Prefabricated Buildings. Prefabricated units such as commercial coaches, house trailers, etc., registered with the Department of Motor Vehicles or the Department of Housing and Community Development, are tangible personal property even though they may be connected to plumbing and utilities. A mobilehome which meets or is modified to meet, all applicable building codes and regulations and which is permanently affixed to realty, is an improvement to realty and is not personal property.

A contract to furnish and install a prefabricated or modular building similar in size to, but which is not, a factory-built school building (relocatable classroom) is a construction contract whether the building rests in place by its own weight or is physically attached to realty. It is immaterial whether the building is erected upon or affixed to land owned by the owner of the building or is leased to the landowner or lessee of the land.

Generally, a contract to furnish and install a small prefabricated building, such as a shed or kiosk, which is movable as a unit from its site of installation, is a construction contract only if the building is required to be physically attached to real property by the seller, upon a concrete foundation or otherwise. The sale of such a unit to rest in place by its own weight, whether upon the ground, a concrete slab, or sills or piers, is not a construction contract even though the seller may deliver the unit to its site of use.

Prefabricated or modular buildings which are “factory-built housing” where permanently affixed to the realty are improvements to realty. The manufacturer of factory-built housing who contracts to furnish and install the factory-built housing manufactured by him or her is the consumer of the materials used in building and installing the factory-built housing and the retailer of the fixtures. Tax applies as provided in (b) above.

(4) Factory-Built School Buildings.

(A) General. On and after September 26, 1989, a contract to furnish and install a factory-built school building is not a construction contract but rather is a sale of tangible personal property.

(B) Definitions.

1. “Factory-built School Building.” The term “factory-built school building” (relocatable classrooms) means and includes:

A. for the period September 26, 1989 through September 12, 1990, any building designed to be used as a school building as defined in Sections 39214 and 81165 of the Education Code and so used. A factory-built school building must be designed in compliance with state laws for school construction and approved by the structural safety section in the office of the State Architect. It must be wholly or substantially manufactured at an offsite location for the purpose of being assembled, erected, or installed on a schoolsite.

B. effective September 13, 1990, any building which is designed or intended for use as a school building and is wholly or substantially manufactured at an offsite location for the purpose of being assembled, erected, or installed on a site owned or leased by a school district or a community college district. A factory-built school building must be designed and manufactured in accordance with building standards adopted and approved pursuant to Chapter 4 (commencing with Section 18935) of Part 2.5 of Division 13 of the Health and Safety Code and must be approved by the structural safety section in the office of the State Architect.

The term does not include buildings licensed by either the Department of Motor Vehicles or the Department of Housing and Community Development. The term also does not include prefabricated or modular buildings which are similar in size to, but which are not, “factory-built school buildings”. It is immaterial whether the building is erected upon or affixed to land owned by the owner of the building or is leased to the landowner or lessee of the land.

2. “Consumer.”

A. For the period September 26, 1989 through September 12, 1990, the term “consumer” as used herein means either (1) a school or a school district or (2) a contractor who purchases a factory-built school building for the purpose of fulfilling the requirements of an existing contract with a school or school district to furnish and install such building.

B. Effective September 13, 1990, the term “consumer” as used herein means either (1) a school district or a community college district or (2) a contractor who purchases a factory-built school building for the purpose of fulfilling the requirements of an existing contract with a school district or a community college district to furnish and install such building.

(C) Place of Sale. The place of sale or purchase of a factory-built school building is the place of business of the retailer regardless of whether the sale of the building includes installation or whether the building is placed upon a permanent foundation.

(D) Application of Tax.

1. Tax applies to 40 percent of the sales price of the building to the consumer excluding any charges for placing the completed building on the site. The sales price of the building shall include amounts representing tangible personal property installed in the building by a subcontractor, whether prior to or after installation of the building at the site, provided such installation is called for in the prime contract for the building. A separate contract to furnish and install tangible personal property in a factory-built school building after installation of the building at the site is a construction contract and tax applies as in (b) above. Any contract or subcontract for site preparation (e.g., foundation) is a construction contract and tax applies as in (b) above.

2. The sale of a factory-built school building to a purchaser who will resell the building without installation is a sale for resale and the seller may accept a resale certificate from the purchaser. If the purchaser then sells to a contractor who has an existing contract to install the building on a school site, tax will apply as in (c)(4)(D)l. above. If tax has been paid on the purchase price of a factory-built school building which is subsequently resold for installation, a tax-paid purchases resold deduction may be taken as provided in Regulation 1701 (18 CCR 1701).

(E) Exclusion Certificate. For the period September 26, 1989, through September 12, 1990, if the purchaser certifies in writing to the retailer that the factory built school building purchased will be consumed in a manner or for a purpose entitling the retailer to exclude 60% of the gross receipts or sales price from the measure of tax and uses the property in some other manner or for some other purpose, the purchaser shall be liable for payment of tax measured by 60% of the sales price. For the above stated period, all retailers who make retail sales of “factory-built school buildings” claimed to be subject to tax measured by 40 percent of the sales price must obtain from the “consumer” a signed certificate substantially in the form set forth below.

CLAIM FOR 60% EXCLUSION FROM TAX ON
PURCHASE OF FACTORY-BUILT SCHOOL BUILDINGS
(Sec. 6012.6, Rev. & Tax. Code)

I hereby certify that the factory-built school building that I

(Name of Purchaser-Consumer)

am purchasing under the authority of this certificate from

(Name of Retailer)

will be used as a school building as defined in Sales and Use Tax Regulation 1521. My seller's permit number, if any, is_____.

I further certify that I understand and agree that if the property purchased under the authority of this certificate is used by the purchaser for any purpose other than indicated above, the purchaser shall be liable for payment of tax to the State Board of Equalization at the time of such use measured by 60% of the sales price of the factory-built school building.

Signed by_____
(Name of Purchaser)

As:_____
(Owner, Partner, Purchasing Agent, etc.)

Date_____

(5) Mobilehomes Installed for Occupancy as Residences. Operative July 1, 1980, a special measure of sales or use tax is provided for a mobilehome sold to be affixed to realty for occupancy as a residence.

A mobilehome dealer who sells a new mobilehome to a construction contractor to be affixed to land for occupancy as a residence is the "retailer-consumer" of the property and is required to pay tax for the period in which the sale was made by the dealer measured by an amount equal to 75 percent of the retailer-consumer's purchase price of the mobilehome.

A construction contractor who withdraws a new mobilehome from an inventory purchased for resale to be affixed to realty for occupancy as a residence in the performance of a construction contract is required to pay tax measured by 75 percent of the purchase price by his or her mobilehome vendor except where the purchase is made directly from a mobilehome manufacturer. In the absence of satisfactory evidence of the vendor's purchase price it shall be presumed that the measure of tax for the transaction is an amount equivalent to 60 percent of the sales price of the mobilehome to the construction contractor.

A mobilehome manufacturer who sells a new mobilehome directly to a construction contractor for installation to real property for occupancy as a residence is required to pay tax measured by 75 percent

of the sales price at which a similar mobilehome ready for installation would be sold by the manufacturer to a retailer-consumer in this state. A construction contractor who withdraws a new mobilehome from an inventory purchased from a manufacturer for resale must pay tax measured by 75 percent of his or her purchase price.

A mobilehome manufacturer who performs a construction contract by permanently affixing a new mobilehome to real property is the consumer of the material and the retailer of fixtures installed by him or her and the tax applies as set forth in paragraph (b) above.

Reference should also be made to the provisions of Regulation 1610.2 for additional interpretative rules relating to custom additions to the mobilehome prior to sale, transfers of nonvehicle items, and the application of the tax to a purchase made from an out-of-state retailer.

(6) Repair Contracts. A contract to repair a fixture in place or a fixture the contractor is required by the contract to reaffix to the realty is a construction contract. Sales or use tax applies to the gross receipts or sales price of the parts sold by a contractor who is a retailer under this provision. Either sales tax or use tax applies to the sales price of the parts sold to or used by a contractor who is a consumer under this provision.

(A) United States Construction Contractors. A United States construction contractor is the consumer of the parts furnished in the performance of a construction contract to repair a fixture.

(B) Construction Contractors Other Than United States Construction Contractors.

1. A contractor is the retailer of the parts furnished in the performance of a construction contract to repair a fixture when the sale price of the parts is billed separately from the repair labor.

2. A contractor is the consumer of the parts furnished in the performance of a lump sum construction contract to repair a fixture.

(7) Elevator Installations. A large number of components are included in the installation of an elevator system. Those portions constituting the cage or platform and its hoisting machinery are fixtures. The balance of the installation, if attached to a structure or other real property will generally be "materials."

Similarly, installation of escalators and moving sidewalks are in part fixtures and in part materials.

Following are examples of components constituting part of the cage or platform and its hoisting machinery, and which are fixtures:

alarm bell	door operator on cab or car	power units and control boxes
cab or car	door safety edge on cab	pumps
car doors	door sills on cab	pushbuttons on cab
car platform and sling	electronic door protector	wire and piping (which are

door hanger on cab	jack assembly	components of a fixture)
door openers	motors	

Following are examples of components constituting “materials” when attached to realty:

car guides	hoistway door sills and jams	sound insulating panels on “materials”
casing section of jack assembly	hoistway door supports	structural steel (unless part of
guide rails	hoistway entrance	cab, car, or other “fixture”)
hoistway doors	pushbuttons on hoistway	valve strainer
hoistway door frames	rail buckets	wire and piping attached to
hoistway door safety edge	sill, struts	“materials”

Following are examples of components constituting parts of escalators or moving sidewalks which are fixtures:

staircase	chains	other operating mechanisms
moving sidewalk	sprockets	
moving handrails	motors	

(8) Telephone Switchboards and Instruments. Telephone switching equipment installed in a building specifically designed to accommodate the equipment or attached to a building or structure in a manner such that its removal would cause damage to the equipment or building in which it is installed will be considered to be “fixtures” under paragraph (a)(5) of this regulation.

Telephone handsets, modular switching equipment and standardized, off-shelf, general purpose switching equipment sold for use in general purpose office buildings constitute machinery and equipment under paragraph (a)(6) of this regulation. Handsets, modular switching equipment and standardized equipment were previously classified as fixtures.

This change in classification shall be applied prospectively only with respect to construction contracts entered into on and after July 1, 1988, by contractors other than United States construction contractors.

(9) Deep-Well Agricultural Pumps. A deep-well agricultural pump is tangible personal property if installed so that it rests in position by force of gravity and is not otherwise affixed to the land.

The pump is a fixture if:

- (A) It is affixed to the land such as by concrete, bolts or screws,
- (B) It is physically connected to an irrigation system such as by pipes or couplings so as to become an integral part of the system, or
- (C) It is enclosed by a pump house or other building or structure .

(10) Remote Control Garage Door Openers. Remote control garage door opening units are fixtures. Portable transmitter units furnished pursuant to a construction contract are deemed to be fixtures and are taxable as provided in subdivision (b)(2)(B). Sales of portable transmitter units not a part of a construction contract, as, for example, sales of replacement units, are retail sales of tangible personal

property and subject to tax as such.

(11) Modular Systems Furniture. Except as provided below, a contract to sell and install modular systems furniture, including panelized office systems, frees-standing units or other systems, is not a construction contract. Persons who contract to sell and install modular systems furniture are retailers of the items which they sell and install, and tax applies to the entire contract price less those charges excludable from gross receipts or sales price pursuant to Sections 6011 and 6012 of the Revenue and Taxation Code. Retailers who claim a deduction for such charges should maintain complete and detailed records to support the amounts claimed. Such records should include, but not be limited to, a separate accounting of charges for installation labor, such as labor to affix, bolt, fasten, or hardwire panels to realty and labor to fasten or affix fully constructed components to fully constructed panel systems or other components. Charges for fabrication labor, such as labor to attach, assemble, connect, construct, or fabricate panel systems or components, labor to attach or connect one panel to another to form workstations or cubicles, and labor to construct or fabricate the individual panels, components, or accessories are subject to tax.

A contract to furnish and install panelized office systems entered into on or after October 1, 1999, which requires the permanent attachment of panels and components to realty, regardless of the order, manner, or method of attachment, is deemed a construction contract and the system a fixture when installed. When the construction contractor is a United States construction contractor, tax applies as provided in (b)(1). For construction contractors other than United States construction contractors tax applies as provided in subdivision (b)(2)(B)2. Notwithstanding any other provisions of this regulation, when the contract does not state the sales price, the sales price is deemed to be 85% of the total contract price, excluding charges attributable to free-standing casegoods or free-standing storage items, including desks, credenzas, lateral files, bookcases, worktables, returns, convergents, corner units, storage towers, chairs and footrests, but including all other charges.

A contract to furnish and install wall panels or demountable wall units, so that they are firmly affixed and fastened to the floor and to the ceiling of a building or structure so as to lose their identity as panels and become an integral and inseparable part of the realty, is a construction contract. Such wall panels or demountable wall units are materials, and tax applies as provided in subdivision (b).

(142) Excess Reimbursement. The excess tax reimbursement provisions of Regulation 1700 apply to construction contractors.

Appendix A The following is a list of typical items regarded as materials:

Asphalt	Linoleum	Steel
Bricks	Lumber	Stone
Builders' hardware	Macadam	Stucco
Caulking material	Millwork	Tile
Cement	Mortar	Wall coping
Conduit	Oil	Wallboard
Doors	Paint	Wallpaper
Ducts	Paper	Wall-to-wall carpeting

Electric wiring and connections	Piping, valves, and pipe fittings	(when affixed to the floor)
Flooring	Plaster	Weather stripping
Glass	Power poles, towers, and lines	Windows
Gravel	Putty	Window screens
Insulation	Reinforcing mesh	Wire netting and screen
Lath	Roofing	Wood preserver
Lead	Sand	
Lime	Sheet metal	

Appendix B The following is a list of typical items regarded as fixtures:

Air conditioning units	Furnaces, boilers, and heating units
Awnings	Lighting fixtures
Burglar alarm and fire alarm fixtures	Plumbing fixtures
Cabinets, counters, and lockers (prefabricated)	Refrigeration units
Cranes ¹ (including moving parts of cranes) affixed or annexed to a building, structure or fixed work	Signs
Electric generators (affixed to and accessory to a building, structure or fixed works)	Television antennas
Elevators, hoists, and conveying units	Transformers and switchgear
	Vault doors and equipment
	Venetian blinds

¹Moving parts of cranes are classified as machinery and equipment when furnished and installed pursuant to fixed price construction contracts entered into prior to July 1, 1985.

Appendix C The following are lists of typical items regarded as:

Machinery and Equipment	Not Machinery or Equipment
Drill presses	Fixtures and materials as defined in this regulation
Electric generators (unaffixed, or, if affixed, which meet the requirements of subparagraph (a)(6))	Wiring, piping, etc., used as a source of power, water, etc., for machinery and equipment
Lathes	Radio transmission antennas
Machine tools	Large tanks (i.e., over 500 barrel capacity)
Printing presses	Fire alarm systems
	Street light standards
	Cooling towers other than small prefabricated cooling units

Note: Authority: Section 7051, Revenue and Taxation Code

Reference: Sections 6006 - 6010, 6012, 6012.2., 6012.6, 6012.8, 6012.9, 6015, 6016,
6016.3, 6016.5, 6055, 6091-6095, 6203.5, 6241-6246, 6276, 6276.1, 6379,
6384, 6386, 6421, 6901.5, Revenue and Taxation Code.